

# Report of the auditor-general to the Northern Cape Provincial Legislature and the council on Kgatelopele Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Kgatelopele Local Municipality set out on pages X to X, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information..

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting

estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

6. The municipality did not correctly account for assets in accordance with GRAP 17 *Property, plant and equipment*. The municipality did not determine the correct deemed cost at initial recognition. Consequently, infrastructure assets as disclosed in note 3 in the financial statements was overstated by R963 848 (2015: R1 100 087); accumulated depreciation on infrastructure assets was overstated by R1 038 375 (2015: R904 679) and depreciation was overstated by R138 017 (2015: R138 017). Furthermore, capital purchases were identified that were not accounted for in the Annual Financial Statements. Consequently, work in progress was understated and cash and cash equivalents overstated by R8 367 155 respectively. Additionally, there were differences identified between the asset register and the amount disclosed in the financial statements. Consequently, property, plant and equipment was overstated and impairment loss understated by R1 752 858. There was a resultant impact on the surplus for the period and on accumulated surplus.
7. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment as there were differences between the general ledger and the amount disclosed in the financial statements. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to property, plant and equipment stated at R 248 397 316 in note 3 to the financial statements were necessary.

### Irregular expenditure

8. The MFMA requires the municipality to include particulars of irregular expenditure in the notes to the annual financial statements. The municipality incurred expenditure in contravention of the supply chain management (SCM) requirements. This was not included in the irregular expenditure disclosed in note 47 to the financial statements. I was unable to determine the full extent of the understatement as it was impracticable to do so. In addition, the municipality did not have adequate systems to maintain complete records of irregular expenditure and I was not able to confirm the amount of irregular expenditure to be disclosed by alternative means. Consequently, irregular expenditure disclosed in note 47 of the financial statements was understated by R7 410 294 (2015: R13 835 184).

## **Unauthorised expenditure**

9. The municipality did not fairly disclose unauthorised expenditure incurred during the year, as required by section 125 (2)(d)(l) of the MFMA. As a result unauthorised expenditure was understated by R13 903 314. Consequently, unauthorised expenditure disclosed in note 45 of the financial statements is understated by R13 903 314.

## **Commitments**

10. The municipality did not have adequate systems in place to record commitments, which resulted in commitments being overstated by R11 760 055. In addition, I was unable to obtain sufficient appropriate audit evidence as the municipality did not maintain accurate and complete records of the contractual information used to determine commitments. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to commitments stated at R20 460 055 (2015: R23 844 270) in the financial statements were necessary.

## **Cash and cash equivalents**

11. I was unable to obtain sufficient and appropriate audit evidence for cash and cash equivalents disclosed in note 11 of the financial statements and I could not confirm the balance by alternative means. Consequently, I was unable to determine whether adjustments made to the bank overdraft stated as R4 172 075 was necessary.

## **Payables from exchange transactions**

12. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions as the municipality did not have adequate systems to maintain records for unknown bank transfers, accrual creditors, unallocated receipts and salary control account. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to payables from exchange transactions stated at R9 182 140 in note 16 to the financial statements was necessary.

## **Provisions**

13. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as provisions in note 15 to the financial statements and I could not confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustment to the provisions stated at R7 405 711 in the financial statements was necessary.

## VAT Receivable

14. I was unable to obtain sufficient appropriate audit evidence for VAT receivables as the municipality did not have adequate systems to maintain records for VAT receivables. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the VAT receivables stated at R5 834 946 (2015: R3 574 699) in the financial statements was necessary.

## Inventories

15. The municipality did not recognise all assets that met the definition of inventory in accordance with GRAP 12, *Inventories*. Land that was held for distribution was incorrectly classified as property, plant and equipment. Consequently, inventory was understated and property, plant and equipment overstated by R3 425 410 respectively.

## Receivables from non-exchange transactions

16. The municipality did not account for all receivables from non-exchange transactions in accordance with the requirements of GRAP 1, *Presentation of financial statements*, as the municipality did not have adequate systems to maintain records of receivables from non-exchange as there were differences identified between the accounting records and the amounts recorded on the financial statements. Consequently, receivables from non-exchange transaction and revenue from non-exchange transactions were overstated by R1 087 901 (2015: R4 501 711) on the financial statements. Additionally, the municipality included future debt in the calculation of allowance for doubtful debts. I was not able to determine the full extent of the misstatement in receivables from non-exchange transactions as it was impracticable to do so.

## Consumer Deposits

17. During 2015, the municipality did not account for all consumer deposits as required by GRAP 1, *Presentation of financial statements*, as the municipality recorded consumer deposits without receiving physical cash. Consequently, consumer deposits and trade receivables from exchange transactions were overstated by R944 956. Additionally, there was a resultant impact on the surplus for the period and on accumulated surplus.

## Revenue from exchange transactions

18. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for service charges. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the corresponding figures of service charges stated at R32 438 087 in the financial statements was necessary.

## Revenue from non-exchange transactions

19. The municipality did not measure government grant and subsidies revenue in accordance with GRAP 23, *Revenue from non-exchange transactions* as there were unexplained differences identified between the accounting records and the amounts recorded in the financial statements. Consequently, government grants and subsidies were understated and unspent conditional grants and receipts overstated by R1 213 909 (2015: R1 483 121) respectively. Additionally, there was a resultant impact on the surplus for the period and on accumulated surplus.

## Expenditure

20. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for employee related cost; general expenses and actuarial gains/losses. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the corresponding figures of employee related costs stated at R18 669 170; general expenditure R15 000 872 and Actuarial gains/losses stated at R423 031 in the financial statements was necessary

## Qualified opinion

21. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Kgatelopele Local Municipality as at 30 June 2016 and their financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA..

## Emphasis of matters

22. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Going concern

23. Note 43 to the financial statements indicate that the municipality's current liabilities exceeded its current assets by R8 843 000. This condition, along with other matters as set forth in the note, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## Material losses

24. As disclosed in note 48 to the financial statements, material losses to the amount of R 8 762 899 were incurred as a result of distribution losses of electricity.

## Additional matters

25. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### Unaudited disclosure notes

26. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

### Unaudited supplementary schedules

27. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

28. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

29. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Development priority 1: Basic Service Delivery on pages x to x
  - Development priority 2: Spatial Development and Transformation on pages x to x
  - Development priority 3: Local Economic Development on pages x to x
30. I evaluated the usefulness of the reported performance information to determine whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

31. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
32. The material findings in respect of the selected development priorities are as follows:

## **Basic Service Delivery**

### Usefulness of reported performance information

33. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance and be measurable. A total of 20% targets were not specific and measurable.
34. The FMPPI requires that performance targets should specify the period or deadline for delivery. A total of 100% targets were not time bound.
35. The FMPPI requires that indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 20% indicators were not well defined.

### Reliability of reported performance information

The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. Adequate and reliable corroborating evidence could not be provided for the reported achievements against planned targets relating to 20% of indicators. This was due to a lack of monitoring of the source documentation in support of actual achievements, as well as the lack of frequent review of the validity of reported achievements against source documentation.

## **Spatial Development and Transformation**

### Usefulness of reported performance information

36. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 33% reported indicators were not consistent with those in the approved integrated development plan.
37. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance and be measurable. A total of 33% of

performance targets were not specific

- 38. The FMPPI requires that performance target should specify the period or deadline for delivery. A total of 33% targets were not time bound.
- 39. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 33% of performance indicators were not well defined.
- 40. The FMPPI requires that the processes and systems that produced the indicator should be verifiable. A total of 33% of performance indicators were not verifiable.

## **Local Economic Development**

### Usefulness of reported performance information

- 41. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 67% indicators were not verifiable.

### Reliability of reported performance information

- 42. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets were not reliable when compared to the evidence provided. This was due to a lack of monitoring of the source documentation in support of actual achievements, frequent review of the validity of reported achievements against source documentation.

## **Additional matters**

- 43. I draw attention to the following matters:

### Achievement of planned targets

- 44. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 39 of this report.



## Adjustment of material misstatements

45. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of Basic Service Delivery, Spatial Development and Transformation and Local Economic Development. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

## Compliance with legislation

46. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## Strategic planning and performance management

47. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation; electricity and solid waste removal were not set by the municipality as required by section 43(2) of the MSA and the municipal planning and performance management regulation 10(a).

## Financial statements, performance and annual reports

48. The annual performance report for the year under review did not include a comparison of the performance with the previous financial year as well as measures taken to improve performance as required by section 46 (1) (b) and (c) of the MSA.
49. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
50. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.

## Procurement and contract management

51. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1)
52. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the Preferential Procurement Policy Framework Act.

## **Expenditure management**

- 53. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
- 54. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Revenue management**

- 55. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Liability management**

- 56. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

## **Consequence management**

- 57. Unauthorised, Irregular and Fruitless and Wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act.

## **Internal control**

- 58. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual report and the findings on compliance with legislation included in this report.

## Leadership

- 59. Management did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
- 60. Management did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
- 61. Management did not establish and communicate approved policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities
- 62. Management did not develop and monitor the implementation of action plans to address internal control deficiencies previously identified by the internal and by the external auditors.
- 63. Management did not establish an information technology governance framework that supported and enabled the business, delivered value and improved performance.

## Financial and performance management

- 64. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
- 65. Management did not implement controls over daily and monthly processing and reconciling of transactions.
- 66. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
- 67. Management did not review and monitor compliance with applicable laws and regulations
- 68. Management did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

## Governance

- 69. Appropriate risk management activities were not implemented to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a strategy to address the risks was developed and monitored

Kimberley

30 November 2016



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*